HM Revenue
& Customs

Regulatory Capital Securities Regulations

Who is likely to be affected?

Banks, building societies and investment firms.

General description of the measure

This measure makes provides certainty of tax treatment of securities issued to meet new regulatory requirements imposed by EU legislation.

Policy objective

This measure makes the tax system simpler by ensuring that the issuers and holders of these new forms of regulatory capital, Additional Tier One securities (AT1) and Tier Two securities (T2), which banks, building societies or investment firms will be required to issue with certainty of tax.

Background to the measure

This measure was announced in Budget 2013. A consultation on the draft Regulations took place from 16 July 2013 and closed on 15 September 2013.

Detailed proposal

Operative date

This measure will have effect for AT1 and T2 securities which are not shares issued on or after 1 January 2014 or for securities which are not shares which are issued before that date but which meet the conditions to be AT1 or T2 securities in the Regulations as at that date.

Current law

Section 221 Finance Act 2012 allows HMT to make regulations to make provision about the tax consequences in relation to securities issued in relation to any regulatory requirement imposed by EU legislation.

The Basel III requirements, which are adopted in Europe via the Capital Requirements Directive IV and the Capital Requirements Regulation (CRR) introduce new regulatory prudential requirements with which financial institutions will have to comply when issuing institutions new forms of regulatory capital (AT1 and T2). The CRR applies from 1 January 2014 and therefore these Regulations come into force on that date.

To comply with the requirements of CRR, AT1 and T2 securities must have a number of features which are designed to aid loss absorbency in the event of a financial crisis. These features make the tax treatment of new AT1 and T2 securities uncertain as the current tax rules were not designed with these securities in mind.

Proposed revisions

The regulatory capital securities which AT1 and T2 replace are treated as debt for tax purposes and as AT1 and T2 share features with debt type instruments it has been decided that debt treatment is appropriate for these securities.

This measure provides that for the new type of AT1 and T2 securities to which the regulations apply ("regulatory capital securities") to be taxed as debt and so provide credit institutions or investment firms with certainty of tax treatment to ensure that tax uncertainty does not discourage these entities from issuing more loss absorbent forms of capital.

The loan relationship rules will apply to regulatory capital securities subject to certain specific rules in relation to the issuer of these securities and, in the case of a connected company, the holder of these securities (these specific rules do not apply to holders of RCS that are unconnected to the issuer). These specific rules provide that the corporation tax provisions treating an embedded derivative or equity instrument as a separate contract are disapplied, fair value accounting of the security is not permitted for tax purposes and no credits or debits are brought into account in relation to certain conversions, write-downs and subsequent write-ups of the security arising as a result of a bank, investment firm or building society breeching a regulatory trigger or nearing insolvency. This will reduce potential tax burdens where an entity is in financial difficulty.

This measure also provides that payments (other than repayments of the principal amount) in respect of regulatory capital securities are not distributions for tax purposes but are treated as income chargeable under Chapter 2 Part 4 of Income Tax (Trading and Other Income) Act 2005 (interest) for income tax purposes this would include not just interest payments but any premium paid or discount received. The Regulations provide an exception from the duty to deduct tax in relation to these payments. Transfers of regulatory capital securities will be exempt from stamp duty.

This measure will not apply to a regulatory capital security if there are arrangements were the main or one of the main purposes is to obtain a tax advantage in respect of that security.

In addition the measure provides that the issuer is not required to deduct tax from payments made on a regulatory capital security. An issuer cannot rely on the exception from the general duty to deduct tax from interest paid by banks or authorised persons dealing in financial instruments.

The Loan Relationship and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (the Disregard Regulations) are amended to apply to regulatory capital securities that are accounted for as equity in the same way that they currently apply to a company's own share capital. This will ensure that where an issuer of a foreign currency regulatory capital security enters into either a foreign currency loan relationship asset or a derivative contract to reduce their exposure to exchange gains and losses any gain or losses on the loan relationship or derivative contract will not be brought into account. In addition regulation 6 of the Disregard Regulations is amended to limit the effect of regulation 6(5) and 6(5B) elections where the hedged item is a regulatory capital security to which the company applies fair value accounting.

Transitional provisions will ensure that where a regulatory capital security is issued before these Regulation come into force but which meet the definition of regulatory capital security and are accounted for using fair value accounting any increase or decrease in carrying value of these securities is brought into account as either a credit or a debit. This will ensure there is continuity in the tax treatment and that amounts are not left out of account or brought into account more than once.

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	nil	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	This measure will have no impacts on individuals and households; it relates to financial institutions that are subject to Capital Requirements Directive IV and the Capital Requirements Regulation.					
Equalities impacts	There are no impacts on any group which shares a protected characteristic.					
Impact on business including civil society organisations	This measure will have a negligible impact on business including civil society organisations: the measure only impacts on financial institutions that are subject to Capital Requirements Directive IV and the Capital Requirements Regulation; it provides these entities with certainty on the tax treatment of Additional Tier 1 and Tier 2 regulatory capital instruments.					
Operational impact (£m) (HMRC or other)	The costs to HM Revenue & Customs (HMRC) will be negligible.					
Other impacts	There are no other impacts anticipated.					

Monitoring and evaluation

This measure will be subject to ongoing monitoring through receipts and information collected on tax returns.

Further advice

If you have any questions about this change, please contact Fiona Hay on 03000 585 882 (email: fiona.hay@hmrc.gsi.gov.uk).

Declaration

Sajid Javid MP, Financial Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.